

MONTANA STATE FUND STUDY COMMITTEE

November 12, 2002

Elkhorn Room - Holiday Inn Downtown

The second Montana State Fund Study Committee Meeting was held on October 25, 2002 at the Holiday Inn Downtown, 22 North Last Chance Gulch, Helena, Montana.

Committee Members Attending

Rep. Rick Laible	Sen. Walter McNutt
Rep. Joe McKenney	Jerry Driscoll
Rep. Gary Matthews	Larry Jones
Sen. Vicki Cocchiarella	George Wood
Sen. Dale Mahlum	Angela Huschka

Others Attending

Murray Steinman, Facilitator
Stacey Bird, MPEA
Larry Kibbee, Alliance of American Insurers
Tom Horn, MSF Board Member
Steve Bender, Department of Administration
Brenda Voller, BKBH
Jeane Carstensen-Garrett, Legislative Audit Division
Stuart Doggett, Helena
Bob Biskupiak, Payne Financial Group
Webb Brown, Montana Chamber
Carl Kochman, Wendt Kochman
Mari Gray, State Auditor
Lorretta Lynde, MSF Board Member
Curtis Larsen, Montana State Fund
Jerry Keck, Department of Labor and Industry
Joe Mazurek, Crowley Law Firm
Roger McGlenn, IIAM
Thomas Schneider, MPEA
Jacqueline Lenmark, American Insurance Association
Jason Todhunter, Montana Logging Association
Rick Edwards, Northwestern Energy
Keith Olson, Montana Logging Association
Riley Johnson, NFIB
Carl Swanson, Montana State Fund
Nancy Butler, Montana State Fund
Mark Barry, Montana State Fund
Matthew Cohn, Montana State Fund
Kathy Gowen, Montana State Fund
Sue Weingartner, Alliance of American Insurers

Chairman Walter McNutt called the meeting to order at 10:06 a.m. The minutes from the October 25, 2002 meeting were approved as presented.

Angela Huschka, Deputy Insurance Commissioner, gave a presentation on the difference between the way private carriers and the State Fund are regulated. Ms. Huschka spoke about the examination process. The proposed bill provides that the State Auditor's office would conduct an annual examination of the State Fund's financials. The Insurance Commissioner's office currently contracts out to provide that service for private carriers. The Department recently contracted out for two of the largest health insurers and the cost ranged from \$20,000 to \$50,00. Ms. Huschka's estimate is that because of the complexity of the State Fund, the first couple of exams would probably cost closer to \$50,000. This exam would be done every five years, so it would not be a yearly fiscal impact. The Department would probably want to do an exam within the first one or two years, then five years after that. The Insurance Commissioner's office would need to contract the review of the State Fund's rates out to an actuarial firm. Private carriers are required to use NCCI loss costs. NCCI files loss costs with the Insurance Commissioner's office. A carrier may deviate either up or down from the NCCI loss costs. If they are below the loss costs, it is prior approval, meaning that the Insurance Commissioner's office must approve those rates before they can be used. If they are above the loss costs, it is file and use. The carrier may use the higher rates, but there is explicit language in the statutes for the Insurance Commissioner to determine if the rates are excessive. Even though it is file and use, the Insurance Commissioner's office requires additional back-up information for justifying those rates. The private carriers use the loss costs and add their individual general and administrative expenses, and they must show justification for why they are deviating from NCCI's loss costs. Ms. Huschka stated that she is not sure how much an actuarial review of rates would be, but she believes it would be upwards of \$20,000 for a thorough rate review process. Ms. Huschka asked Mari Gray, State Auditor, if carriers file annually or only when new rates are filed. Ms. Gray responded that carriers do not have to file annually if their multiplier is above one. If their multiplier is below one, and they are on prior approval, they must file each year. Mark Barry, Montana State Fund (MSF) VP Corporate Support, stated that MSF's audit, which is a review of rates and reserves, cost \$10,500 this year.

George Wood asked if the rates that NCCI files include MSF's experience. Ms. Gray responded that all carriers' experience, including MSF's, are included.

Rep. Laible asked a question regarding NCCI classifications. His understanding is that most of NCCI's classifications are used by the State Fund, with the exception of about 30 classifications. If MSF were held to NCCI's rates, would it hinder the State Fund? Ms. Gray responded that it is her understanding that the proposed bill would not require the State Fund to follow the classifications as set out by the Classification and Review Committee, which is created by law to set classifications. Rep. Laible asked about deviation of rates, and if the State Fund's rates were significantly higher or lower, how would the Auditor's Office address that? Ms. Huschka stated that NCCI files their base loss cost, and a carrier can deviate above or below that by adding in their experience for that period of time. Ms. Huschka stated that she is not sure how the State Fund intends to follow that process, and she understands that the State Fund is exempting itself from

using NCCI only, and that it can use other variables. If private carriers deviate below, it is prior approval and the Insurance Commissioner requires justification. If they are not comfortable with the justification, there is a hearing process set out in statute. The same thing goes with excessive, which is file and use. However, the Insurance Commissioner has the authority to require additional information to ensure that they are backing up that information with true losses and expenses. If an agreement is not reached between the carrier and the Insurance Commissioner's office, there is a hearing process.

Carl Swanson, MSF President/CEO, spoke about the priorities in MSF's proposed legislation. The key items are: protecting MSF's surplus, a structure that allows MSF to function more efficiently and effectively as a non-state agency, and ensuring that MSF retains its role as the guaranteed market, providing options for Montana businesses. As discussed in the last study committee meeting, it would be a hardship for the Retirement Division if MSF's employees were not be in the system, so MSF's employees will remain in the retirement and health benefit system. Another priority for MSF is to ensure that the long-term needs of Montana businesses are protected in having a viable option for workers' compensation insurance. Mr. Swanson stated that MSF re-drafted the bill to show MSF's absolute priorities. MSF would be an independent public corporation, not subject to state agency operational requirements. The condensed version of the bill, which is limited to priority #1, reflects strengthened language protecting the surplus, protection of the status of MSF's employees, and includes the current oversight by the Legislative Audit Division. All other aspects of the bill, such as payment of premium tax, Insurance Department regulation with exceptions, and possible purchase of the MSF building have been taken out so the committee can see what priority #1 looks like. It would be helpful to MSF if the committee could provide feedback as to whether the other pieces should or should not be in the bill. Mr. Swanson stated that MSF would still like to have a name change, but he does not want it to compromise the committee's support of priority #1. The Old Fund is something that needs to be remembered so it doesn't happen again, but MSF would like to change the perception of MSF. This would be recognition that today's company is different that it used to be. As some committee members did not like "mutual", MSF's preference has been narrowed to CompSource Montana. Mr. Swanson stated that MSF exists to provide an option for businesses in Montana. MSF has provided this option through a depression, two world wars and 81 Cat-Griz games.

Rep. Matthews asked what would happen if the auditor came back with a low rate, then made a report to the Governor, the Legislature and the Board of Directors. He asked if there has been an audit in the last 10 years where the auditor has pointed out a low rate. Mr. Swanson stated that MSF has not been under the Insurance Department or the auditor in the past. Tillinghast Towers Perrin reports to the Board, and an independent actuary issues a report to the legislature on whether MSF's rates are excessive, inadequate or unfairly discriminatory. Every year they have found that they are within the acceptable range. Rep. Matthews stated that there was no process on the rate, which is something that concerns him. The legislature would not raise MSF's rate because it would be political suicide. Mr. Swanson stated that currently MSF's oversight is provided by the legislature and the Board of Directors. The Legislative Audit Division currently provides a report in the "Blue Book". MSF has to appear before the Audit Committee on the findings. MSF writes a letter to the Legislative Audit

Division on any recommendations that may have been made. Mr. Swanson stated that he thinks that if the legislature were unhappy with MSF's response, they are in a position to take action on that. Rep. Matthews asked if the legislature would actually take action, and stated that it is a concern of his. Mr. Swanson replied that the Board of Directors is strong, and they accept their fiduciary responsibility. He believes they would be concerned if a report reflected that something was inadequate. He believes they would be asking questions of the outside actuary, and he is confident that action would be taken. He believes that this illustrates the importance of the change that was made from the Old Fund to the New Fund in appointing a seven-member Board of Directors who recognize their fiduciary responsibility, and that the appropriate action would be taken at that level. MSF also has an outside, independent actuary who ensures adequacy of rates in the aggregate. If there is an issue with an individual class code, Mr. Swanson believes that the Board would take action. Senator McNutt asked if there has ever been an instance where a legislative audit report found that a subclass was not adequate or was overpriced. Mr. Swanson replied that it is his understanding that that has never happened. Senator McNutt agreed that was his understanding also. Senator McNutt commented that Greg Petesch made a point that if there were problems, the legislature would act. He does not believe that the committee can predetermine what the legislature would do. Senator Cocchiarella stated that the legislature has not acted in the past when there was artificial rate suppression, and that there is no guarantee. The reality is that the legislature did what it did for several reasons - one being political rate suppression. The Legislative Auditor had oversight in those days, and the legislature did nothing about it. Mr. Swanson replied that political rate suppression emanated from the legislature in 1989, and that the committee needs to keep in mind that there were no checks and balances in place. There was no Board of Directors appointed by the Governor. The legislature has helped structure the State Fund so that will not happen again.

Senator McNutt stated that he would like to have Murray Steinman, Facilitator, walk the committee through the priorities, beginning with Priority # 1. Once that is done, he would like to go on to the rest of the priorities.

Mr. Steinman stated that priority # 1 has two components. The first one deals with the actual structure of the organization and has four components.

- (1) An independent public corporation
- (2) Not a state agency
- (3) The status of MSF's employees
- (4) New name

Mr. Steinman asked the committee members how they felt about the question of MSF being an independent public corporation, not subject to state agency requirements.

Rep. Laible stated that he is in support of the independent, public corporation, but needs clarification on the "subject to state agency requirements" part. As long as that meets the parameters that the committee has spoken about, he agrees with it. He does believe that the committee needs to maintain a level playing field, while at the same time continuing as the insurer of last resort.

Senator Mahlum stated that he is in favor of the independent, public corporation, because sometimes the legislative process can be too cumbersome. The State Fund is a large business, and it must be able to act sometimes without waiting for the legislature. As long as there is a Board of Directors, selected by the Governor, he believes the State Fund will be in good shape, and should not be subject to the micro-management of the legislature.

Rep. McKenney also supported setting the State Fund up as a public entity. He believes it is important to take the politics and the emotion out of the State Fund. It is easy for legislators to forget that the State Fund is supported by the employers who pay into it, and not necessarily by tax dollars through the general fund. The legislators tend to see the surplus, and spend so much time and effort trying to balance the budget on the backs of the people who need an efficient workers' compensation program. He stated that he is in total support of doing whatever can be done to bring the politics and emotion out of the State Fund.

Ms. Huschka stated that she has mixed feelings on this issue, and that as a representative of a state agency, it is difficult for her to support exemptions from state agencies, because she has to deal with those requirements on a daily basis. She stated that she is trying to stay neutral, and not support or oppose.

Senator Cocchiarella said that to make a blanket statement about whether she likes the proposal or not is shortsighted, and does not go to the details she believes the committee needs to consider. She referenced the list on page two, specifically "Priority # 1 - Ensure Organizational Strength and Stability". Ms. Cocchiarella agreed with MSF being the successor in interest to State Compensation Insurance Fund. Regarding non-profit, independent corporation, she generally agreed, but stated that she had questions about the bill draft which she wants addressed. She does not agree that the State Fund should be the guaranteed market, and believes that other state agencies should be set free. Ms. Butler clarified that the topic in the bill was actually insurer of last resort. Senator Cocchiarella agreed that insurer of last resort was appropriate. She still has some questions about non-state agency status.

Mr. Driscoll stated that he agrees that MSF should be exempt from many of the requirements of state agencies. He asked if the list provided by Nancy Butler is everything MSF wants to be exempted from. Ms. Butler stated that it was everything she could find, although she could not guarantee that she did not miss something. Mr. Driscoll stated that he did not believe that MSF should be subject to a lot of the requirements, but he also asked why other agencies have to be subject to them if they are so bad.

Rep. Matthews stated that he agrees with the public corporation part. Over the years, the State Fund has been exempted from other things, and he believes that less bureaucracy is good.

Mr. Wood stated that he has no problem with the public corporation idea. The make-up of the public corporation will need to be considered carefully by the committee, including both the requirements and the exemptions. The name does not mean much. He

believes that there should be a level playing field. Some of the exemptions should be allowed in the interest of efficiency.

Mr. Jones stated that he is strongly opposed to the proposal that the State Fund be a public corporation, and that the role of government is not to compete with private corporations. He said that it is especially true that the current State Fund and the proposed State Fund would continue to have unfair competitive advantages; for example, the monopoly on state business. He stated that we have learned through painful experience that having a State Fund competing with the private sector is a recipe for disaster, and this is just a different version of that same recipe.

Senator McNutt said that he would support Priority #1 for several reasons. The State Fund is not an agency today, but is an entity assigned to an agency. It is a function that is totally separate from other agencies, and it is different because of some requirements to do business in this state. An employer must carry workers' compensation insurance in order to have the no-fault, exclusive remedy protection. The State Fund must be the insurer of last resort and there will no doubt be some competitive inequities. There may be some things that need to be weeded out in the bill, and hopefully the committee can work through the questions to make sure that those problems are answered in the bill.

Mr. Steinman asked if the committee felt that because the State Fund is the insurer of last resort, it should be free from some state requirements.

Rep. McKenney replied that the State Fund provides a needed service for businesses in Montana, and they are the guaranteed market. Employers can go to the open market, but to some businesses the open market is not attractive. Therefore, it is vital that the legislature do everything it can to make that guaranteed insurer as efficient as it possibly can, so those people who do not have a choice will still have an affordable rate.

Mr. Steinman asked if the committee had questions about exemptions from state agency requirements.

Mr. Wood asked a question about the liability exposure. He stated that it appears that the new entity would be granted a limited third-party liability. Currently, there is a limit to the amount of damages and no punitive damages. He stated that because of being the insurer of last resort, the State Fund has received some perks - the \$9 million of premium generated by public agencies, no federal or state income tax, and no premium tax.

Senator McNutt asked if MSF could be subject to punitive damages, even though there are public monies involved. What benefit would there be do doing that?

Nancy Butler advised that as the guaranteed market, Montana State Fund has a public purpose, and as such could remain exempt from punitive damages. However, the legislature also has the option of exempting Montana State Fund from punitive damage protection.

In reference to a question, Joe Mazurek stated that the Montana Supreme Court had faced this issue and upheld limiting an award of punitive damages against the State Fund.

Larry Jones stated that Mr. Mazurek was referring to *Birkenbuel v. State Fund* and that the Court upheld the lower court not imposing punitive damages on a bad faith case because the State Fund was insured under the comprehensive state insurance plan, which was where the money would come from to pay punitive damages. The purpose of punitive damages is to punish and change the behavior of the person against whom the damages are imposed, and that would have been the taxpayers and not the management of the State Fund at that time. Regarding Senator McNutt's question of what is the benefit, Mr. Jones stated that the State Fund has an unfair competitive advantage because it does not have to staff and train people to avoid punitive damages. That is a cost of doing business that it does not have to bear. Also, the injured workers insured by the State Fund do not have the consumer protection of going against a very bad insurance company who has improperly denied a claim. There are two benefits to punitive damages - leveling the playing field and consumer protection. It is very easy to get around the *Birkenbuel* decision by requiring that any punitive damages be paid for out of the State Fund's reserves and/or surplus, the way private insurance carriers do now. In this state, insurance against punitive damages cannot be obtained unless it is expressly set forth in the policy, and in other states it is against public policy to insure against punitive damages. It is very easy to get the benefit of punitive damages by imposing that liability against reserves and surplus, and therefore making State Fund management accountable for the adjusting practices of their adjusters. He emphasized that it is the conduct of the insurance adjusters, and not the insured, that exposes a company to punitive damages and bad faith.

Senator Cocchiarella stated that she works as a claim adjuster, and that she has to make sure that she pays benefits timely and adequately. If she doesn't, she can be sued personally for bad faith, and the owner of the business can be sued as well. Senator Cocchiarella works for a small, third party administrator in Kalispell. She asked if it is fair that she has to operate under the threat of a bad faith suit. She thinks it is unfair to injured workers who end up with the State Fund and have adjusters who do not have the same burden of training. She does not believe it is a level playing field, and it is not fair to her that the State Fund's adjusters can operate without the same level of consumer accountability.

Ms. Butler stated that MSF is subject to bad faith today, and it is called common law bad faith. The *Birkenbuel* case clarified that MSF would be subject to bad faith for its actions. Private companies are covered by Title 33, and they are subject to statutory bad faith. Ms. Butler stated that there is not a lot of difference between common law and statutory bad faith. MSF is covered by the Department of Administration - Risk Management and Tort Defense - they are MSF's insurance company for liability. MSF can be sued and adjusters can be named personally in lawsuits. If adjusters are named in lawsuits, Risk Management and Tort Defense provides their defense, for which MSF pays them a fee every year for insurance coverage. Therefore, MSF and its adjusters are subject to bad faith, and MSF trains its adjusters to avoid bad faith. In addition, an injured worker who is not satisfied can take MSF to mediation and the Workers' Compensation Court. Senator Cocchiarella asked Ms. Butler to clarify the limits of

liability. In the statutory code, Title 2, Chapter 9, the limits on liability are \$750,000. MSF has never had a case where it exceeded that.

Mr. Wood stated that the original proposal was going to make MSF subject to bad faith and punitive damages. He clarified that MSF is not subject to punitive damages now, because it uses its state agency status to avoid what Plan 1 and Plan 2 adjusters have, because there is public money involved. Mr. Wood stated that it isn't the damages for the bad faith that bothers MSF, but the punitive damages. Mr. Wood stated that the exemption from punitive damages bothers him. Ms. Butler stated that "governmental entity" in the statutory code today is very broad, and it includes the State Fund by definition. Mr. Wood asked if the original proposal suggested that MSF be subject to punitive damages. Ms. Butler replied that if MSF was under Insurance Commissioner regulation, had surplus protection and operational flexibility, it had proposed being subject to statutory bad faith and not having protection from punitives or liability limits.

Senator Cocchiarella asked Ms. Butler to explain about the exemption from bonds of state officers and employees. Ms. Butler stated that those sections of law say that the state will buy bonds for its employees, but if MSF needed bonds, it would buy them for its staff. Senator Cocchiarella asked if the State Fund owns vehicles. Ms. Butler replied that there are a number of employees who travel extensively as part of their work, so those employees are assigned a car purchased by the State Fund. In addition, there are a couple of vehicles available for any employee, but MSF also has access to the state motor pool. Senator Cocchiarella asked if MSF would continue to have access to the state motor pool under the proposal. Ms. Butler stated that MSF would not have access to the motor pool.

Mr. Steinman asked the committee members to provide their opinions on liability exposure.

Rep. Laible stated that his concern is that MSF be able to act as a private business, and speed and flexibility are important. These issues should also be looked at for other state agencies. However, he does not want them to have an unfair advantage over the private marketplace. Rep. Laible stated that he thinks MSF should have the same liability as private carriers do. MSF still has some advantages, such as having the state agencies, which are a captive market. He stated that the committee should be deciding if it wants to go forward with this procedure, and if so, which one of the items can be added in or taken out, which will make for a level playing field.

Senator Mahlum stated that he would like to see the limits of liability and punitive damages remain the same. He believes that the State Fund is an entity that is needed badly by the majority of the small businesses in Montana. He believes that the large corporations have stakeholders they have to pay dividends to, and they are not interested in the small operations. It is important to retain the State Fund as an entity that can take care of the small businesses.

Rep. McKenney stated that Rep. Laible spoke very well, and he agreed with much of what he said. He believes that the State Fund will probably always be "the big gorilla" in Montana regarding workers' compensation. He believes that it is vital that there is a little bit of the fear factor in making sure that employees and employers are handled

properly. Part of that fear factor is the threat of a lawsuit. He leans toward having the State Fund's liability be just as it is for private companies.

Ms. Huschka stated that there will never be a level playing field, because the State Fund is the insurer of last resort. She does not believe the committee has fully explored what that means, or who that market is. She does not think the committee has agreed on the items presented at the last meeting. She said the question is: Who is the guaranteed market, and to what extent should there be exceptions because they are the insurer of last resort? She believes that the guaranteed market issue changes if there is true competition in the industry. If there is true competition, the insurer of last resort becomes a smaller market, because there is more availability for businesses to get insurance. As the State Fund has huge advantages over private carriers in the way that they are able to operate and keep premiums lower than other carriers, she believes that the guaranteed market issue becomes smaller as there is less competition in the market place. Therefore, she believes that the committee needs to be very careful in the exceptions it gives because of the guaranty issue, and she thinks that the State Fund should be treated more like a private carrier.

Senator Cocchiarella stated that she is sure Liberty Northwest would not want legislative oversight and review of their company, and they would not like to have their right to turn down a customer taken away. Senator Cocchiarella referred to a package she presented at the last meeting, and stated that she thought her package would level the playing field while still creating a situation where the State Fund would have advantages appropriate to being the insurer of last resort. She stated that this issue is one of protecting consumers, mostly injured workers. This would also be a trial attorney's dream. Senator Cocchiarella does not believe it is an advantage relative to being the insurer of last resort, and MSF needs to be under the same kind of limits and levels as everyone else.

Mr. Driscoll said that he believed this item should be removed from the list, and he also believes that if MSF wants to be independent, they should not be able to get into the comprehensive insurance plan of the state.

Rep. Matthews stated that he believes the State Fund should have the same exposure to liabilities that private companies have.

Mr. Wood stated that he stands for leveling the playing field. MSF's proposal would leave better than half the employees of better than half the employers in the state without the same opportunity in third-party bad faith actions. Therefore, he believes this item should be removed.

Senator McNutt asked Mr. Jones how many times private companies are sued, and how many times do they prevail? Mr. Jones stated that it is important to distinguish between measuring the effect in terms of court ordered damages, because very few cases in any area of the law actually go to trial and reach judgment. The way that punitive damages are used in insurance bad faith is as a club to beat the company into submission to settle the case. There are no reliable statistics. However, Mr. Jones stated that in the private sector, bad faith is a major concern and is taken extremely seriously. Adjusters are trained and staff to make sure injured workers receive the benefits to which they are

entitled so the company is not exposed to that kind of liability. In the workers' compensation system, the case can be taken to the Workers' Compensation Court, and if the company unreasonably delays or refuses benefits, Judge McCarter can award a 20% penalty, which is often a precursor to a demand for bad faith damages. Since Mr. Jones has been at Liberty Northwest, he can recall only three times complaints were filed. Two are still pending, and there has never been a judgment on them. Senator Cocchiarella stated that punitive damages are the hammer and the threat.

Senator McNutt stated that he will not go against the committee's consensus, but if the committee finds out that because of public money, there is a restriction on allowing punitive damages, he would take the steps to recommend that the committee take that out.

Mr. Steinman asked if Senator McNutt would recommend that this item (2.9 part 1) be removed from the priority list, subject to the legality of this issue, and if that was the committee's consensus. Senator McNutt replied that it was. Mr. Steinman stated that there was also a recommendation by Mr. Driscoll that 2.9 parts 2 and 3 also be struck, and asked if the committee had come to a consensus on that issue. Rep. Laible asked if someone could explain why that is in the proposal. Ms. Butler stated that Title 2, Chapter 9, Parts 1, 2 and 3 cover the liability, insurance and claim issues. They all intertwine, and MSF had recommended in its alternative approach that MSF retain all of those, with the option to potentially buy its own insurance coverage. To some extent, they go together as a package. Rep. Laible clarified that MSF is getting their comprehensive insurance coverage through the state. Ms. Butler agreed, and stated that MSF had recommended staying with that approach. If MSF is not going to go with that approach, they would need to sort out some of the applicability issues.

Mr. Driscoll asked Ms. Butler if MSF were not exempt from liability limits, would the state comprehensive insurance plan allow MSF in? Ms. Butler stated that they might have some issues, and the committee would need to get the Department of Administration's position on that. Mr. Swanson stated that if MSF were subject to punitive damages, MSF would want the ability to purchase its own insurance. Mr. Steinman asked Mr. Swanson to clarify that in the event that the liability issue must stay in, then MSF would want parts 2 and 3 along with part 1. If 2.9 part 1 goes out, 2.9 parts 2 and 3 will also go out. If 2.9 part 1 must stay in, MSF would want 2.9 parts 2 and 3 to stay in. Therefore, the consensus of the committee is that it wants 2.9 out, but it may not be legal.

Mr. Steinman asked if there were any other questions. Mr. Driscoll asked a question about the proposed exemption to Title 18(2) - Construction Contracting. He stated that normally a state agency can't build a building without the legislature's permission, and that there are many things in 18(2) that are important to him. Ms. Butler stated that she believes the language in the statute uses the term "state agency", and the bill would state that MSF is exempt from everything applicable to a state agency, therefore MSF would not be subject to this chapter. Mr. Driscoll asked if MSF has taken out that it is subject to going to the legislature if it wants to build a building. He asked Ms. Butler if it was her opinion that MSF could build a new building with premium dollars, not subject to the approval of the legislature. Ms. Butler agreed. Mr. Driscoll stated that he objected to the removal of 18(2), and he wants it left in the law that MSF is subject to

18(2) - Construction Contracting. There are many things in that law, such as prevailing rates, fringe benefits, etc. He believes that MSF should be subject to 18(2). Senator Mahlum stated that the Montana Heritage Commission is able to build a building for \$200,000 or less, without any state approval. It does have to go through all the processes, such as contracts, etc. Mr. Driscoll stated that the Montana Heritage Commission could build a building as long as it complies with 18(2). Senator Mahlum replied that is true, but they do not have to have oversight from the state. Mr. Driscoll asked if the Commission is subject to competitive bidding. Senator Mahlum stated that they are. Mr. Driscoll stated that MSF's proposal removes them from competitive bidding. Rep. Laible stated that perhaps what Mr. Driscoll is concerned about is the nuts and bolts within 18(2), and the committee should get some clarification on what parts of 18(2) are going to cause concern. Rep. Laible stated that if the committee is going to create a "public company" and they want to remodel their building, they should have the right to do it. Going to the legislature every two years is not going to help MSF. Rep. Laible stated that if there are parts of 18(2) that are a problem, the committee should exclude everything but those.

Mr. Driscoll stated that Rep. Laible has the right idea. If MSF is going to be exempt from the laws that say that it must go to the legislature to remodel a building, that is fine, but they shouldn't be exempt from competitive bidding or prevailing rate, because some of the money is public money. Mr. Driscoll stated that the Contractor's Association would have a problem with exempting MSF from competitive bidding.

Mr. Steinman asked if Mr. Driscoll would be willing to include 18(2) if there was a provision added that stated that any construction would go through a competitive bidding process. Mr. Driscoll stated that there are many important things in that chapter. He believes that allowing MSF to build a building without legislative oversight would be fine, but they still must comply with 18(2). Ms. Butler replied that MSF might need to sort through some of the sections, but that Mr. Driscoll's proposal would be acceptable, and in fact, MSF would want to go through a competitive bid process. Mr. Steinman clarified that the proposal is that MSF could build a building or remodel the existing one without asking the legislature, provided that they follow 18(2). Mr. Wood stated that the consensus of the committee was to look at the Chapter to see what should remain and what should come out, because it is probably a laundry list in that section. Senator Cocchiarella stated that even the university system, which is directed by the Board of Regents, which makes its own decisions, still has to go to the legislature to build buildings. If the committee has not made a decision to sell the building to MSF, it is a state building, and the legislature is responsible for the building. Senator Cocchiarella does not believe that legislators should pass off review of any construction if the building is going to belong to the state in the end. Mr. Steinman asked if Senator Cocchiarella's feelings would change if the building were sold to MSF. Senator Cocchiarella replied that she still is not comfortable with the idea of selling a state building to a state entity, so she still believes there needs to be legislative oversight in the construction of the building. She would possibly be comfortable with a \$200,000 limit on a remodel of the building. Rep. Laible stated that he sees Senator Cocchiarella's point, and that he believes the committee needs to provide some flexibility, but with limitations. Then if MSF wants to build a building, or anything in excess of a certain set limit, it would have to go back to the legislature. Senator McNutt stated that because MSF is a creature of the legislature, he agrees that it would be

irresponsible of the legislature to allow MSF to build a building. He also agreed with Senator Mahlum's proposal to allow remodel or renovation within dollar limits. Senator McNutt gave an example of a case where MSF was not able to purchase the building, and then decided to build a building. He believes that MSF should still be answerable to the legislature. Mr. Steinman clarified that 18(2) would be moved back to the list of things MSF would still be subject to, but modified with a certain dollar amount where MSF can do some remodeling without going to the legislature. Mr. Wood asked Rep. Laible if this proposal goes along with his proposal that there might be other things in the chapter that might be stricken. Rep. Laible stated that the chapter would be put back into the list of things that do apply, but with some modifications, based on the Montana Heritage Commission. Senator Cocchiarella stated that she would not feel comfortable putting that kind of language into the bill until she sees it. She asked Senator Mahlum if there was any way to get a copy of the language after lunch. Senator Mahlum replied that he would try to get it.

Mr. Driscoll stated that the committee needed to look at 18(8) regarding Architect and Engineering Services. If MSF did decide to remodel or build a new building, the current law requires that the company must have an architect and an engineer. Mr. Steinman stated that it does not seem to be a big issue with MSF. Senator McNutt agreed with Mr. Driscoll that MSF needs to be subject to that section. Senator Cocchiarella said that she still has concerns about information technology and MSF being totally disconnected in review and purchase. She is still concerned with the interfacing activities of state government, and MSF's purchases of other things and how that could impact or interfere with MSF's or the state's operation. Mr. Swanson replied that this is one of the key pieces of MSF's legislation, which is currently having impact on MSF. MSF is currently on its own client server system, and is supporting itself. To get Board approval, then to have to go to State Procurement, and then have to go to the State CIO is inefficient. There may be differences of direction between the CIOs. MSF needs to be able to move speed to market, get Board approval, and then make mistakes if that is the case, and then be accountable for those mistakes. This piece is absolutely, critically important to MSF. Senator McNutt said that he shares some of Senator Cocchiarella's concerns, and asked Mr. Swanson how much information sharing currently occurs between MSF and other state agencies. Mark Barry, MSF VP Corporate Support, replied that MSF currently reports on SABHRS for accounting, human resources, payroll services, and warrant writing services, and the Board of Investments handles MSF's investment activity. Senator McNutt asked if there were other ancillary technology information systems MSF needs to provide services to its customers. Mr. Swanson agreed and stated that MSF is working with the Department of Administration, and according to Brian Wolf, CIO, there are some areas where MSF can maintain the necessary links with the State that will work for the State and MSF by agreement. Those services are important, but MSF would have to maintain the appropriate linkage for ancillary services. Between now and the session, MSF can work out its approach. MSF needs the ability to be able to go to its Board of Directors for IT issues.

Senator Cocchiarella asked Steve Bender, of the Department of Administration, a question. At the last meeting, MSF stated that it was considering making these changes over a two-year period or so, to get disconnected from services such as mail services and check cutting. Under the Montana Electronic Government Services Act and Information Technology, everyone in state government pays to be involved. When

MSF moves out of these centralized services, will the cost be spread over the agencies that are left? Mr. Bender replied that was correct. Senator Cocchiarella asked if there are things Mr. Bender sees where MSF has to stay in for any connection they have, regarding the Montana Electronic Government Services Act. Mr. Bender replied that he would dismiss the Montana Electronic Government Services Act, because it deals with on-line delivery of services. It is much like MSF's vision of using a lot of internet activity to provide services to their clients. In terms of the general IT infrastructure, Mr. Bender feels that nothing technically precludes MSF from providing a lot of its own services. Connections for data can still be maintained. Mr. Bender stated that the Department of Administration feels that they provide their services cost-effectively, and that they can provide their services cheaper than they can be purchased from the private sector. If the committee wants MSF to be on the same playing field as private carriers, maybe they should not be able to use Department of Administration services, because there is an unfair price advantage. This is a different question than if the committee wants to minimize the overall cost of IT to state government. That would suggest that MSF should, as much as possible, stay within the state IT infrastructure. It is a philosophical thing - do you want to minimize costs to state government and to rate payers, or do you want to level the playing field?

Senator Cocchiarella asked Mr. Barry if he had considered the option of staying with Department of Administration for IT services. Mr. Barry replied that with the way the bill is written, MSF would have the opportunity to utilize Department of Administration's services until 2007. Senator Cocchiarella asked why it was until 2007. Mr. Barry responded that MSF is utilizing the state of Montana network services to get out to its customers. MSF's vision is to go to a business to business e-model so that MSF can control what information is provided to its customers, as well as providing securities to its customers. MSF has told the Department of Administration and ITSD that it is anticipating 30,000 users, and they will have to provide the security if MSF remains on their services. MSF would rather have that capability and control in-house, because MSF is not sure what type of security the state of Montana would provide, and MSF does not want to put liability on the State for that type of security. MSF would rather have the ability to provide on-line services. Currently, the state of Montana has a portal, but they do not have the ability to make on-line application. MSF wants to be able to share data with its insureds, and needs to be able to control the security. MSF has a proposal in front of the State CIO asking for his approval to move in that direction, and MSF is getting some push back on that. MSF wants to be able to contain the security. When an agency is involved with the entire state, it is at the mercy of whose priorities come into play first. MSF's priorities take first seat. Senator Cocchiarella stated that it is just an issue of timing, and not having access to those services later. Rep. Laible stated that he shares some of Senator Cocchiarella's concerns about MSF having the ability to start a new electronic infrastructure, but he stated that the committee needs to remember that MSF still has a Board of Directors. If the committee does not allow MSF to be run as a business, then the committee is probably wasting its time. The committee should allow them to operate in a free market, with oversight. If the oversight is to the point where it is dealing with day-to-day operations, it is going to hurt MSF's opportunities, and as such, hurt the opportunities for small businesses that depend on affordable and available workers' compensation insurance.

Mr. Steinman clarified that it is cheaper to buy services from the state of Montana, but it is important to MSF to have speed to market, which is an economic advantage. In addition, MSF wants the ability to manage their own services in a way that is effective to their clients. Mr. Steinman asked the committee to provide their ideas on this issue.

Senator Cocchiarella stated that she agrees with Mr. Swanson that MSF needs to have flexibility, although she does have some concerns for other agencies and the Department of Administration and their budget issues in a time of crisis. Mr. Steinman asked if Senator Cocchiarella would consider going with MSF's IT proposal. Senator Cocchiarella replied that she would be ok with that, but she is concerned about the other agencies, and she still has not received an answer for that. Mr. Swanson stated that the financial impact is about \$680,000. Most of that is the IT budget under the CIO, and MSF has indicated that it will keep them whole under the biennium, to give them time to be planning for the change. The dollar impact is less than \$700,000 per year, which gives them two years to plan. There should also be some decreased workload. In the original survey of state funds, only one state fund (Pennsylvania State Fund) is tied into the computer system, and Pennsylvania is very much a state agency type of state fund. All the other state funds are able to operate in their own IT environment, recognizing that it is not taxpayer dollars, but premiums. Senator Cocchiarella said that although she does not disagree with the concept, the committee needs to be aware that it will be \$1.4 million more in cuts over the biennium. Mr. Wood stated that the committee has talked from the beginning about allowing MSF to increase its efficiency and security. What's been explained is that the IT proposal needs to be in there to do that. The other thing in the background is making the premium payers of the State Fund subsidize other state agencies. He said that it does not make sense to him. He is a rate payer, and he does not believe he should be subsidizing something that has to do with other agencies. Rep. Laible stated that if it is more efficient for MSF to be out of the state system, maybe other state agencies should look at this also. Mr. Swanson stated that the state is funded by taxpayer dollars, so there is some wisdom in the legislature's feeling that they should be sharing a common vision. MSF is funded only by the premiums of businesses that elect to insure with them and is created in statute to be a competitive business. MSF's direction may not necessarily be the same direction as the state.

Senator Mahlum asked when the proposal would be fully implemented. Ms. Butler replied that the proposal provides that MSF would not be a state agency, and would be a public corporation next July. Senator Mahlum clarified that he meant only the IT proposal. Ms. Butler replied that through 2007, MFS would have the option to obtain services from the Department of Administration. Senator Cocchiarella stated that when Mr. Swanson said that MSF does not use taxpayer money, he must have given the state agencies out to the rest of the world to compete for. Mr. Swanson replied that he considers the money the state agencies pay for workers' compensation insurance to be insurance premiums. The university system pays insurance premiums, either to a private carrier or MSF. The state purchases services from the private sector with taxpayer dollars, but what they are getting in return is a product or insurance coverage.

Mr. Steinman asked the committee if they could reach consensus on what MSF would be exempt from and what they would not be exempt from. Mr. Driscoll asked if the whole issue of public contracting in 18(1) was in the proposal. Ms. Butler stated that

MSF would not be subject to that, and is not subject to most of it today. Mr. Driscoll stated that he can see the point regarding 18(7) - state procurement and surplus property, but there are many things in 18, and there are some things in 18(1) which he believes MSF should be subject to. Ms. Butler stated that she would be willing to go through that section with Mr. Driscoll and that they could possibly do it at lunch, with a caveat that it wasn't an in-depth review. Mr. Steinman asked if there were some issues in Title 18 that are of concern to Mr. Driscoll. Mr. Driscoll replied that there are things like competitive bidding, prevailing rate, use of an architect and engineer, and going through A & E at the Department of Administration. MSF should have to comply with those rules. If they want to build a building, they must comply with Title 18. Ms. Butler stated that MSF is willing to work with Mr. Driscoll on competitive bidding and architects, but MSF is looking for latitude with, for example, buying office equipment. MSF wants to be exempt from the procurement portion of Title 18, and having to use the state processes and procedures for buying goods and contracted services. Mr. Wood stated that he had misunderstood. His understanding of Rep. Laible's proposal was that MSF was going to look at Title 18, and the things that were to be thrown out would be thrown out. Rep. Laible stated that the committee would look at Title 18, and Title 18 would stay in, except for the items that are causing a problem. No one wants MSF to build a building without an architect. Rep. Laible recommended taking out the items that cause MSF to not be able to operate efficiently. Senator McNutt stated that he is not sure the committee needs to micromanage that, and the committee has generally agreed upon some principles, and it needs to go into the bill draft that way, and the committee needs to move on. Mr. Steinman asked if the committee was ready to reach consensus on the elements that MSF has proposed and the committee has modified, in terms of what they would no longer be subject to. The committee agreed that it had reached consensus.

After the lunch break, Mr. Steinman asked Mr. Driscoll what his consensus was regarding Title 18. Mr. Driscoll replied that Eddy McClure, of Legislative Services, suggested that language be put into the bill stating that MSF is exempt from Title 18, except for those sections relating to construction and remodeling. Ms. McClure said that the language would probably be "exempted from non-construction goods and services".

Mr. Steinman stated that the next item on the agenda is MSF not being a state agency. The State Fund would continue on as not a state agency. Mr. Steinman asked if that was generally acceptable to the committee, and if there was any comment or discussion. The committee agreed that this was acceptable.

Mr. Steinman brought up Priority # 3, which is MSF's employees' status as public employees. He asked the committee if there was any discussion or consensus. Senator McNutt stated that he thought the committee went through that issue at the last meeting, and that because MSF is a public entity, the employees are state employees. Mr. Wood stated that he was not sure if they decided that they were state employees, but they did decide that they would stay under PERS. He stated that he thought the committee decided not to call them state employees, because of some other issues. Senator McNutt said that the question is: Can they be other than state employees? Joe Mazurek, of the Crowley law firm, stated that MSF's employees are public employees, but they are not subject to the State Classification and Pay Plan. Mr. Steinman asked if the committee could reach consensus that MSF's employees are public employees.

Senator Cocchiarella asked Ms. Butler where it stated that the employees are not state employees. She also asked Ms. McClure about the language that states “they are not employees of the state of Montana” and then the next one that says “employees of the State Fund are employees of the state”. She wanted to make sure that language is correct, because she does not want issues that can’t be predicted. Ms. McClure replied that the language should probably be rephrased. The committee reached consensus on Priority #3.

Mr. Steinman raised the issue of new name options. He stated that Mr. Swanson suggested the name CompSource Montana. Senator Mahlum said that after the last meeting he did a lot of thinking about the name issue. He believes that the committee must do what is best for the state of Montana and its people who are affected by the name change. He believes that if the name is to be changed, it should be done gradually, taking at least two years. He suggested that perhaps the letterhead could read “State Compensation Insurance Fund, to be known in the future as CompSource Montana” or something similar. He would like to keep the old name so current policyholders would know what is going to happen in the future. Mr. Wood stated that the problem of name change brings up the fact that 60 pages will have to be added to the bill to get the name change every place it goes. If the name is left as it is, the bill will be down to the issues discussed this morning. Senator Mahlum suggested that there be a clause at the end of the bill saying that the new name will go into effect 2 years hence. Ms. McClure stated that the committee would not be allowed to put something in the back of the bill. Hopefully, the legislature will be adopting a new rule during the next session to prevent multiple sections of the code. She suggested putting into every section that the first year it would be called the state fund, and the second year it would be called the new name, with the effective date in that section. If the name is not changed, it would take multiple pages out of the bill. Legislative Services is trying to get away from having multiple sections of the code with multiple effective dates. The rule that Ms. McClure referenced, if adopted, will require a super majority to delay effective dates or termination dates. If the committee is going to delay the effective date of the name change to the second year, in the definitions section it should say “effective 2003 - State Fund” and “effective 2004 - the new name”. Each of those sections would get longer. Mr. Driscoll asked if it would shorten the bill if there were a new section stating that the Board of Directors could change their name if they wish. Ms. McClure stated that would not work, because legally, if they change their name, it would still say “State Fund” in the code. There will be a reference to the new name in the constitution. Ms. McClure stated that the name could also be changed under the corporation laws. Mr. Mazurek added that whatever the entity is, it must be the successor to the State Fund in order to make sure the public funds go with it. He also suggested that under corporation statutes, corporations or partnerships may use an assumed business name. The authority could be given to the Board to do that. Ms. McClure clarified that it would be fine as long as the name is not misleading. Mr. Mazurek stated that when MSF signs a legal document it would have to sign it as State Compensation Insurance Fund, d/b/a whatever the new name is. Mr. Wood asked if it would be possible to have the meat of the proposal in one bill, and all of the name changes in another bill. Rep. Laible said that he has been hesitant about the name change, because it is one more item that might raise a red flag. Two years from now, there will be unintended consequences of this bill. It might be in the committee’s best interest to keep the name as it is. He believes that everyone knows what the State Fund is, and he does not have

a negative connotation from the name. The name could remain the same until the next session, and then people will have had two years to see how the organization operates. Rep. McKenney said that no matter when the name change is made, the same discussion will be held. He believes that the whole point of the name change is that the State Fund is making some changes to adapt to the new realities of serving its customers. They are some serious and positive changes, and Rep. McKenney thinks a name change is a positive move. He believes the committee is trying to micromanage. Mr. Steinman asked for a consensus from the committee.

Mr. Wood stated that he does not think the name should be changed now.

Rep. Laible said that he is in favor of keeping the name as it is.

Senator McNutt asked Mr. Swanson how important the name change is to MSF. Mr. Swanson stated that he did not want it to jeopardize what has been accomplished. MSF can deal with this issue two years from now. He added that there is an option of having one bill deal with the meat of the issues and another dealing with the name change. If there is not a consensus on this issue, MSF will deal with it in the future. Senator McNutt stated that he is not in favor of changing the name right now. He believes it could cause a great deal of dialogue during the session, because it would increase the size of the bill, and a large bill raises suspicions. The name change could be a detriment to having the bill understood, and he recommended that the committee not change the name now. Senator McNutt stated that if the committee desires a separate bill for the name change, he would support that. Senator Cocchiarella said that she agrees with Senator McNutt and what he said about risk, but she does not care about the name change. She asked Mr. Swanson if there were two separate bills, would he want the name change bill to pass if the other doesn't, and vice versa? She believes that the committee needs to go forward, and if it can be put in two bills and go forward that would be fine. However, there needs to be the understanding that both bills would need to go together, the name bill cannot stand alone. Mr. Swanson stated that MSF would not want the name change, and would recommend against signing it, if the first piece of legislation did not pass. Mr. Steinman asked if there was a consensus that the committee would accept a companion bill that would change the name provided that the first bill passed. He also asked if the committee had consensus on the name CompSource Montana. The committee agreed on both points.

Mr. Steinman spoke about strengthening the language regarding surplus/assets, and asked if there was any discussion.

Mr. Jones stated that this would put a firewall between the surplus and the legislature. He asked the committee members if there was any concern that the surplus could become so excessive that it could be used for predatory pricing. Private carriers have as a horror story the Oregon State Fund's build up of surplus to the point where it was believed that it would be used in predatory pricing to select key accounts and beat out private carriers. He asked if there was any concern among committee members that with the firewall, it could lead to predatory pricing. He asked if in the alternative, the committee would consider putting in more specific language; for example, having a surplus ratio of 1.5 to 1.9. Then the State Fund could go to the legislature to have that ratio increased if it thought it was appropriate. Mr. Swanson replied that Mr. Jones' idea

was reasonable, and has already been incorporated into law. It says in statute today, which would remain, that the Board of Directors has to be the body determining how much surplus MSF has, upon recommendation of the outside, independent actuary. MSF's target, in statute, is among AM Best rated companies, reserve to surplus, between 1.5 and 1.9. Mr. Jones asked which statute this was in. Mr. Driscoll asked if MSF reaches 1.9, wouldn't they have to lower their rates? Mr. Swanson stated that in that case, dividends would be considered. Mr. Swanson stated that the language reads "State Fund shall target a reserve to surplus ratio, or surplus at an amount comparable to competitive state funds and private workers' compensation insurers with at least an A rating from AM Best", so MSF is targeting its peer group. Mr. Jones stated that the numbers are not in the statute. Mr. Swanson responded that the numbers may change, for example if the peer group is 1.8 - 2.2, then that what is what the Board should be looking to for guidance. MSF would be targeting their peer group, and the numbers can go up or down. Mr. Jones stated that his proposal is that the authority should be given to the legislature, and he asked the committee to consider that proposal. Senator Mahlum asked why the committee is trying to put handcuffs on the Board of Directors. If the Board of Directors does something wrong, they will be replaced, and the committee should not try to second-guess what the Board of Directors is going to do. Rep. McKenney stated that he is sensitive to Larry's concern, and that all committee members need to be sensitive to that, but he is very comfortable with the language in the proposed bill. He does not feel that the committee needs to micromanage the specific percentages of what the ratio will be. He thinks the window of where the ratio will be is in the peer group, and he thinks that is very appropriate. Senator McNutt is comfortable with that language because it says "shall" - instead of "may" or "could" or "possibly" - but it says it "shall" target those surplus ratios, which are a moving target over time. Actuarial opinions change, and if a definitive number is put down in statute, the legislature will have to be changing it. He believes that the language would preclude predatory pricing, and he believes the Board would not get caught in a predatory pricing situation. Rep. Laible concurred with Senator McNutt and Rep. McKenney. He believes it provides the sideboards for what is needed, and makes it perfectly clear that the money belongs to the ratepayers, and he believes it is important that that be strengthened. Mr. Wood asked Mr. Mazurek about the language and if the money is public money. Mr. Mazurek responded that it is public money because it is held by a public entity and the constitution essentially says that it is public money. The purpose that the legislature says it can be used for is restricted; it is held in trust. Mr. Wood stated that it bothered him that the state of Montana has no claim on the money. He said that he wanted to be clear on whether the money is public money or not, because if it is public money, the state of Montana does have an interest in it. Mr. Mazurek stated that it is not state money, but it is public money, and there is a difference. It is not state funds in the sense that it is taxpayer dollars. It is required to be public money under the constitution so the Board of Investments can invest it, but the use is still restricted under current law. It says exactly what it can be used for - it is for the use and benefit of the insured policyholders. Mr. Mazurek referenced his letter stating that "all premiums, penalties, recoveries earned upon money belonging to the State Fund must be deposited in the State Fund and must be held in trust for the purpose for which the money was collected. If the chapter is repealed, then the legislature has the authority to disperse the money." That is the way most state funds, even the newer ones, operate. They are not subject to dissolution, but if they become insolvent the legislature may dispose of them. The proposed language is directly from

the state of Texas, and is similar to many others. Mr. Wood stated that he does not have any problem with the language, but he got confused by the fact that someone said the constitution could be changed by legislative action. Mr. Mazurek stated that the constitution is a very narrowly drafted document, which states that the money is public funds. However, the legislature can define what those public funds are used for. It is a basic enabling document that the legislature defines what that really means.

Mr. Driscoll asked Mr. Mazurek what would happen if sometime in the future the legislature decided to sell or otherwise get rid of the State Fund, and what would happen to the surplus. Mr. Mazurek said that since MSF is a creature of the legislature, it can be undone by the legislature. It would be up to the legislature to disperse that money, according to §39-71-2322, MCA, "If the chapter is repealed, the money is subject to disposition as provided by the legislature repealing this chapter. In the absence of a legislative provision, distribution must be in accordance with the justice of the matter, due regard being given to the obligations of compensation incurred and existing." Mr. Mazurek also stated that he believed that if this were to happen, there would be some discussion between the employers who paid the premium and the legislators.

Ms. Huschka asked about the struck part that states "shall maintain a minimum surplus of 25% of annual earned premium". She realizes that MSF has reached that point already, and probably does not need that in the statute anymore. She asked the committee if it wanted to get rid of requiring a minimum surplus requirement, in the event that the surplus is not there anymore. She asked the committee to consider not striking that out, as it was put in the statute because of prior concerns, when the State Fund was not at the level it is now. Ms. Butler replied that it was put in the statute in the early days when the State Fund did not have any surplus, but now MSF uses a surplus to premium ratio, and reserve to surplus is a much better test. MSF saw the minimum as an outdated test, and MSF would rather target the upper number rather than the floor. Ms. Huschka asked if there was not a need to have a floor anymore, and maybe it would need to be added in during another session if MSF has lost its excess surplus. Rep. Laible stated that the surplus now is \$150 million, but at 25%, it would be \$25 million. The surplus is well in excess of that, so leaving the language in there would not hurt anything and would provide a base level that MSF has to have. Ms. Huschka said that private carriers have a statutorily required minimum required capital and surplus that they have to have at all times in order for the Insurance Commissioner to not take them into rehabilitation. Ms. Huschka stated that the minimum is based on the line of insurance, and she believes it is \$750,000. Senator McNutt asked what MSF's surplus is now. Ms. Huschka replied that it is \$150 million. Senator McNutt said that MSF has premiums of \$90 million. Ms. Butler clarified that it is actually around \$100 million. Senator McNutt stated that 25% of \$100 million would only be \$25 million, which is far less than is acceptable for surplus. He thinks that if the State Fund started migrating towards that lower number, someone would raise a red flag, and that it is an artificial floor. Mr. Swanson said that is why it was scratched. Later, someone may look at that statute and think it is all right if MSF only has \$25 million in surplus. Rep. McKenney stated that he thinks it is confusing to have both items in the statute - a minimum and the targeted reserve to surplus ratio. He believes that the crossed out language should stay crossed out. Senator McNutt agreed and added that surplus in workers' compensation has a different connotation than surplus in the legislature. If there is

something in statute that states that MSF only has to maintain a minimum of 25%, someone will go after that money. He believes that MSF has gone far beyond those days when that was a needed requirement, and he does not mind if it is struck out of the bill. Ms. Huschka replied that to the extent that surplus is public funds, she is concerned about the excess surplus funds growing to an amount larger than the 1.5 to 1.9 percent ratio, and asked what happens to the excess funds, whether they are refunded to ratepayers or benefits are increased. She is also concerned about the administrative expense ratio, and believes that it should not exceed what other carriers in the market use for expense ratios. She does not want there to be the potential for creating a for-profit subsidiary out of the new public creature. She believes that there are some concerns with the surplus that have not been raised. Rep. Laible replied that he understands Ms. Huschka's hesitancy, but he also stated that MSF would be under the auspices of the Insurance Commissioner. Ms. Huschka replied that might not be true. Rep. Laible stated that it will still be under a Board and the legislature, and if the legislature sees that there is an imbalance, then it will have to take another look. Senator Cocchiarella said that she believes Ms. Huschka's issues are legitimate. If other companies have certain minimum standards, then she believes that the minimum standards should be reflected in the statute. The issue of predatory pricing also needs to be addressed. For example, Blue Cross/Blue Shield has created a for-profit under their tax-free shelter, and the committee needs to make sure that is not creating the same opportunity for the State Fund. Whether Carl Swanson, Nancy Butler, Mark Barry and the existing Board are here ten years from now or not, she wants to make sure that MSF cannot build the surplus to an extent that they can do to the private sector what has gone on. Mr. Steinman stated that he is trying to reach conclusion on the issue of strengthening the language. Mr. Driscoll asked Ms. Huschka if the minimum for private companies is a rule or law and if she knows what it says. Ms. Huschka replied that it is in statute. For private workers' compensation carriers it is \$750,000 minimum, and then there are risk-based capital requirements above that, depending on the amount of premium that is written in a given year. There is a calculation made at the end of every year, based on the premium written that goes over and above that minimum required capital and surplus. Mr. Driscoll asked Mr. Swanson if he could live with Ms. Huschka's definition of minimum capital. Mr. Swanson agreed. Mr. Wood stated that surplus is a percentage of reserve, and is not a percentage of premium. The old statute is based on premium, but things have progressed since then, and now surplus in workers' compensation is based on reserve. A company could reduce their premiums and the statute would keep them under-reserved and under-surplused. Some of the concerns that have come up in the meeting are addressed in the new proposal. Mr. Wood believes that if the committee wants to micromanage, they should go ahead and put a minimum in the statute. He believes that if the money complies with the constitution, then the committee should not get caught up in this issue. Ms. Huschka stated that she is not hung up on the language, but was just raising the issue of having a floor as well as a ceiling. Mr. Swanson stated that the ceiling is dealt with in the wording - MSF is to target a reserve to surplus ratio comparable to AM Best rated peers. If at any point MSF went above other insurers on a reserve to surplus ratio, it would have to suffer the consequences. The peer group is currently within the 1.5 to 1.9 range, so Mr. Swanson believes the issue is dealt with. Mr. Steinman asked if the committee had reached consensus on this issue. The committee agreed that it had reached consensus on the language issue.

At this time, Senator McNutt asked for public comment.

Larry Kibbee, of the Alliance of American Insurers, provided public comment regarding the issue of surplus. First, the ceiling target of peer groups is probably well and good, but that same language exists in Oregon statute. Oregon right now has \$500 million in excess surplus. There is a firewall built between the legislature and the Oregon State Fund. The question is, where is that money going? Mr. Kibbee stated that the money is going back to very predatory pricing. The surplus ought to be returned to the policyholders. However, when there is so much money, and the company can actually give dividends that are probably as much as some of the premiums that ought to be charged, that is where predatory pricing comes into effect, and that's when private carriers leave the state. If you are talking about a level playing field and a message to the rest of the industry and the private carriers in the state, the committee ought to consider at least something that is very strong in terms of that upper level. The language says "shall target" and Mr. Kibbee stated that he doesn't know what "shall target" means. The language doesn't say that if it is not that way, anything can be done about it, except by the Board or the legislature. The legislature meets every two years, and the legislature would be getting a rear-view look on a situation that is given to the legislature every year on an audit. There is some lag time for surplus to be built up. Mr. Kibbee suggested that the floor is equally important. The reason is that many companies have gone down the tube. Recently two of the biggest workers' compensation companies in the world have gone down the tube. It is very easy for someone to say that \$25 million in surplus is fine, but it very well may not be. If the legislature is not in session and ready to go at that point, that hammer will not be pulled. The other issue is whether or not the State Fund ought to be regulated by the regulator. That person is there every day - all day - and that's what they are for. Mr. Kibbee stated that he believes two things on the surplus. The committee needs to make very sure that it has a very specific idea on how high the surplus can go. Secondly, the committee needs to know the same thing on the floor. Regarding companies in trouble, there are very different attitudes on how much is truly enough surplus. For the Alliance of American Insurers and the regular insurers, the Montana Insurance Department tells them how much surplus and how much capital they must maintain, and how much risk based capital over and above that. Mr. Kibbee believes that is the kind of level playing field the committee needs to look at in the whole issue of surplus.

Jacqueline Lenmark, of the American Insurance Association, provided public comment on the subject of surplus, and the concerns that were articulated by Ms. Huschka, particularly related to the floor. Ms. Lenmark believes that there may be another way of approaching that issue without micromanaging the State Fund, and still providing some of the security that concerned parties have. Her suggestion to the committee is that they use the language that is in the bill, which has a mandatory target for the State Fund to use for surplus. The word "shall" is mandatory, and that would be the direction to the State Fund to establish surplus. Then there should be a qualifier at the end of the sentence that says, "but in no event may the surplus fall below..." and then insert the statutory reference that provides the requirement for private carriers. She believes it is § 33-2-109. In that way, the State Fund will be using the best methods available, without being micromanaged, but will provide some assurance for those carriers and other interested parties who would be concerned about those surplus levels falling below some sort of minimum that other carriers have to comply with. Senator McNutt

stated that her comments will help to keep things on the same playing field, and satisfies the question of the floor. He asked Ms. Lenmark what the committee should do to eliminate Mr. Jones' concerns of an extreme surplus and the fear of predatory pricing. Ms. Lenmark replied that she was thinking about this problem, and she believes that there is similar language in statute that could be referenced in a similar way. She believes those are concerns which should be addressed, and she believes they can be addressed without micromanaging the State Fund, and still protect the targets, which should be preserved for the protection of its policyholders. Ms. Lenmark stated that if given a day or two she would be happy to provide some suggested language, after an opportunity to discuss that with the State Fund and the Insurance Commissioner. Ms. Butler stated that § 33-2-109 references the minimum level of surplus, which is \$750,000. § 33-2-1903 lays out the test for the minimums. MSF is in agreement with referencing that type of approach as a floor. As far as excess surplus, Ms. Butler does not recall seeing anything in Title 33 that tells a company how much surplus they can accumulate. MSF wants a competitive environment for all the policyholders in the state, and could consider making a dividend mandatory when there is surplus above the target amount, but that needs to be thought about to make sure there are not some unwanted impacts elsewhere. This could be a possibility, but the language would have to be very clear that it is not mandatory unless MSF clearly has adequate assets set aside. Ms. Butler stated that she would speak with Ms. Lenmark about some of the possibilities.

Mr. Steinman asked if there was any reason to revisit this issue, or if it was all right to move forward. Senator McNutt asked if there was any other public comment. Seeing none, he asked the committee members if they were comfortable with doing some research and coming up with something in the statute that has to do with the floor and a ceiling on surplus. Mr. Driscoll said that he thinks the IRS probably has a ruling on how much surplus a company can have, because if it is surplus, taxes are not paid on it. Senator McNutt stated that is probably correct, a company can't just keep building surplus as a sheltered tax liability. The committee agreed to move forward.

Mr. Steinman asked the committee if there was anything the committee could agree upon quickly. Mr. Driscoll suggested that the issue of the Old Fund money going to the general fund should be an easy issue for the committee to agree upon. Senator McNutt stated that was the consensus at the last meeting, that MSF would present a plan. The committee agreed.

Rep. McKenney stated that he thought that at the last meeting, the committee had agreed upon Priority # 4, that MSF would continue as the sole insurer for the state agencies. Senator Cocchiarella disagreed. Rep. Laible spoke about the issue of Old Fund money going to the general fund. He stated that he got the sense that those funds were paid by ratepayers. Mr. Wood said that the State Fund was bailed out by the payroll tax paid by employers and employees. Rep. Laible said that those monies did not come from the state, but from the ratepayers. He asked how much money the state general fund gave to the State Fund to start the New Fund. Mr. Driscoll stated that the Old Fund gave the New Fund \$12 million in start up money, and then in 1989 there was \$20 million in general fund money that went to the Old Fund. When Lewis was still Budget Director, they got back the \$20 million. The state says they repaid the \$12 million when they made a dividend transfer. Mr. Wood stated that the committee

should not forget that the under funded liability got up to about \$500 million, and the employers and the employees in Montana paid that money. That is where the transfer of \$4-13 million came from. It was paid outside the parameters of the workers' compensation system - it was paid by payroll tax to the Old Fund. Rep. Laible stated that that is his point. It was not paid out of the general fund. The money is being given back to the general fund, when the money actually came from the ratepayers in this state. They might not be the same employers that we have today, but the money came from them, and the committee should recognize the fact that some of that money belongs to them. Mr. Wood stated that the problem is to locate the 400,000 employees and their employers who paid into it. Rep. Matthews stated that he thinks the committee is forgetting how this all started. Basically, the Governor was going to the agencies in the state of Montana and looking for different ways to get some money into the general fund. Some of the businesses were not paying enough premiums, and maybe the Old Fund was mismanaged, but he does not believe they will ever solve that argument. Then, the new State Fund was fully funded, and some of the policies were getting old, and this is an opportunity to put some money in the general fund. Rep. Matthews said that he looks at this as a trade off to be a better agency, and continue down the path they are going. MSF was looking for some concessions, and instead of them having to go to the legislature every two years, the committee is going to make some changes. He stated that if the committee gets into the Old Fund, they would be there until 8:00 p.m. Senator Cocchiarella stated that the question is how to give money back to the ratepayers, because all employees and employers in Montana paid, not just those attached to the State Fund. Mr. Wood stated that self-insurers had never been ratepayers, but they paid the payroll tax. Rep. Laible clarified that there is no way to get the money back to the people who paid it, so the easiest way is to give it to the general fund. Senator McNutt stated that it is a reasonable and logical thing to do, since everyone paid that money in, it would be unfair to pay it back to the employers who are paying in today. The easiest way to do that is to put it back into the general fund, where all taxpayers may have an advantage. Mr. Steinman asked the committee if they were in agreement, and the committee agreed.

Mr. Driscoll suggested that the committee consider the purchase of MSF's office building. Senator McNutt stated that he believed that what MSF is asking is the authority to go to the Land Board and ask to purchase the building. He does not think the committee needs to put in statute that MSF is actually going to buy the building. He would like to see that MSF has the ability to buy the building in the bill - it is just part of the equation. He stated that he thinks it would be a neat scenario if MSF were able to buy the building, because it would do nothing different on the balance sheet. They would replace cash with an asset that may even appreciate in value. If the committee is really concerned about protecting MSF's money, the legislature can't cash the building. Mr. Wood stated that MSF has to want to buy the building, and the Land Board has to want to sell it. Mr. Driscoll stated that when the Land Board sells things, they do not allow just one entity to bid. Rep. Laible stated that the language should be changed to read purchase or lease at fair market value. Mr. Driscoll replied that that is already in the new version of the bill. Senator Cocchiarella stated that it does not make sense for a state entity to buy the building. If the legislature dissolves the State Fund, then what happens to the building? She said that she is not in favor of letting them buy the building. Mr. Steinman asked if the committee had reached a modified consensus to

allow MSF to attempt to purchase the building. Senator Cocchiarella and Ms. Huschka voted no, some committee members abstained, and the rest of the committee agreed.

Mr. Wood stated that the next item the committee should consider was the issue of the collection of premium tax. He said that the premium tax is 2.75%, and that the excess writers for Plan 1, and Plan 2 pay the premium tax. If the State Fund paid a premium tax, as in its original proposal, it would raise about \$3 million for the general fund. He stated that the argument would be made that it would increase premiums. This would be one of the factors, but there is no direct route from premium today to premium with premium tax. It may not increase some policyholders' premiums, if their classification happens to be good, but it would be part of the mix to come up with a possible increase, although it would be relatively slight. Mr. Wood urged the committee to consider that premium tax is a percentage of premiums, and the big accounts will pay the bulk of it, because they pay the largest premium. The more a company's premium is, the more that company will pay, so Mr. Wood does not believe the small employer will be hurt by this. He suggested that the premium tax should be approved. Senator McNutt stated that MSF paying premium tax would be a signal of leveling the playing field, but he has some problems with raising premiums. He said that if it is the consensus of the committee, he can live with it, but he does have a problem with it. Rep. Laible asked how the committee would feel if it was phased in. Ms. Huschka said that she believes it is a signal to the industry of leveling the playing field. It is a cost of doing business to private carriers, which they must consider in pricing, and perhaps there could be a phase in. MSF has stated that it will increase premiums by 2.75%. Perhaps it could be part of their ratemaking in the next year, and be taken into consideration. If it is not a direct collection and pass-through tax, where everyone who purchases from the State Fund has their premiums raised by 2.75%, then maybe it would be a little more palatable. Rep. Matthews stated that he has always felt that MSF should pay the premium tax. The legislature will be looking at finding \$200 million dollars, and \$6 million seems like a small amount, but since other companies pay, MSF should too. Rep. Matthews stated that this is an issue that is dealt with in health insurance, and he doesn't believe MSF should be allowed to be exempt. Senator McNutt asked Mr. Swanson if he truly believes, with the latitude that will be given to MSF, that there will be a 2.75% increase to ratepayers, or if with the restructuring, MSF can be a little more efficient. Mr. Swanson answered that on the short-term there are fixed costs. On the long-term, he believes MSF will have efficiencies and savings. MSF has a 2% contribution to surplus in its ratemaking. Payment of premium tax would result in a 2.75% loading as part of expenses and costs, so on the short-term it would have impact. On the longer-term, MSF is going to realize savings. Senator Cocchiarella stated that she does not want State Fund policyholders to have to pay more to pay a premium tax. The risk is that the premium tax could kill the bill, and could make the difference between an employer hiring or not hiring an employee. She does not believe it is necessary. The State Fund is the insurer of last resort, and a premium tax is a tax she does not believe businesses need to pay. She stated that she is against the State Fund paying premium tax. Mr. Wood asked Senator Cocchiarella if she believes that the premium tax should be removed from private insurers. If she does not want MSF to pay the premium tax, why shouldn't the field be leveled by not having other insurance companies pay the premium tax? He asked if other lines of insurance pay the premium tax. Ms. Huschka responded that the premium tax is on everything except Blue Cross/Blue Shield and the HMO's. Senator Cocchiarella stated that since the State

Fund is an insurer of last resort, which was created by the legislature, there are certain things that the businesses that participate in the State Fund should not have to do to be alike. She said that part of the package in her mind is taking away the guaranteed customer base of state employees. In exchange, would be no premium tax. She believes it is a benefit of the State Fund, as insurer of last resort, to not pay the premium tax. Rep. McKenney stated that he believes that being the guaranteed insurer of last resort requires a certain base, which he thinks is insuring the state agencies. However, as the committee moves the State Fund into a more rapid response, competitive market, as an issue of fairness to the private insurers, Rep. McKenney believes the State Fund should be collecting the premium tax. Rep. Laible agreed with Rep. McKenney and added that the State Fund is the insurer of last resort, and for that they were granted all of the state business. He believes that in order to help level the playing field, the State Fund should pay the premium tax. He stated that he understands that some businesses will have an increase, but it is also true that because the State Fund is the insurer of last resort, many of those businesses could not get insurance on the open market and if they did get insurance it would be much higher than what they are paying at the State Fund. Mr. Steinman stated that it seems to him that there is a linkage in many of the committee members' minds between the premium tax and the sole insurer, and that there is a difference of opinion on how to package it. Mr. Wood said that the State Fund needs to stand on its own. Mr. Steinman asked for a show of hands - eight committee members were in favor of paying the premium tax, and two were against it.

The next issue discussed was that of MSF being the sole insurer for state agencies. Senator McNutt stated that he believed that MSF was the sole insurer of state agencies in order to assist MSF to get on its feet and become healthy, durable and reliable. Senator McNutt asked Mr. Swanson and Senator Cocchiarella if there could be some kind of a phase-in, and if there was a mechanism where MSF could phase out being the sole insurer. He also asked Mr. Swanson his opinion on how much longer MSF would need to be the sole insurer for state agencies to remain vibrant and viable in the competitive market. Mr. Swanson replied that it wasn't that many years ago that MSF was writing \$182 million in annual premium revenue. That came down to \$70 million just a few years ago. 38% of that was rate reductions. When MSF hit \$70 million, state agencies, not including the university system, accounted for about 11% of the volume at that time. One of the reasons that the legislature made that a sole insurer situation in the 1930's was to provide a stabilizing factor. The State Fund's role is to provide stability in the marketplace, and to maintain price integrity. MSF's market share is going to grow when carriers retrench, and drop off when the environment gets very competitive like it has been. MSF would like to retain the state agencies for a stabilizing influence. MSF tries to manage the significant decreases in volume in a competitive market by right sizing through attrition. If MSF was in a market that was significantly decreasing in volume and did not have the state agencies, it could be in a situation of likely having to lay people off. MSF would like to retain state agencies because it is serving a higher public purpose. If it is the committee's input that they are not going in that direction, MSF would definitely prefer this to happen three or four years from now. Mr. Swanson stated that he supposed it could transition by defining the block of business. Typically the business is bid as a block. Senator Cocchiarella stated that to her it is the issue that says you can't have it both ways. If there is going to be a level playing field, this is where it comes from. This is not to say that the State Fund can

never insure state agencies - if they can package, sell and provide a better deal to state agencies, then they will be in the ballgame. In fact, the university system was offered a great deal with a private insurance company, which later dropped them, and they had to go back to the State Fund to be insured. Senator Cocchiarella said that this is the issue that separates the State Fund out and makes them more a public, non-state entity. She believes that this is the issue that makes the playing field uneven, and believes that state agencies should have the opportunity to become self-insured, and save the taxpayers' money. Senator Cocchiarella stated that self-insured programs are generally less costly. Senator McNutt clarified that what Senator Cocchiarella was saying was that the committee needs to let the state agencies opt out of the provision, and be self-insured. He said that in his business experience, when buying property damage and liability coverage, they invariably come in with a package that provides a reduction in workers' compensation insurance for purchasing the property damage and liability coverage. The State Fund can't do that, because all they provide is workers' compensation coverage. He stated that he hopes that if the committee decides to allow state agencies to opt out, there is something that does not allow workers' compensation to be mixed with other packages. Rep. McKenney stated that the committee has been talking about getting to a level playing field, but as long as the State Fund is the guaranteed market, there will never be a level playing field, because the State Fund can't say no to the high-maintenance, high-cost employers. If the state agencies are allowed to go to the open market, the private firms can pick the cream of the crop, leaving the State Fund with the employers who can't go to the private market. This could end up in a vicious cycle; with their rates continuing to spiral up, and some employers might not be able to afford to be in business. Rep. McKenney stated that he agreed completely with Mr. Swanson that the state agencies need to remain as a stabilizing force, because the State Fund is the guaranteed market, and can't say no to the high-cost employers and employees. Senator Mahlum agreed with Rep. McKenney. Mr. Jones stated that all business people would like to have a captive customer base that can't go away, and that is all the state agency business is right now - a captive customer base. He said that Rep. McKenney's comment is well taken - the State Fund, as the insurer of last resort can't say no, but it also can't write for less than its costs, which is true of any insurer that wants to stay in business. When Senator Mercer led the charge for the university system to be allowed to come out from under the State Fund umbrella, and to bid privately, Mr. Swanson was asked the following question. If the state agencies were allowed to go and get requests for proposals for private insurance, could the State Fund successfully compete for that business? Mr. Swanson replied that MSF could compete for the business, just like any private carrier, but if successfully compete means getting the award of the RFP, that would depend on where they come in on product, price and service. Mr. Jones pointed out that the university system is currently with the State Fund. He also stated that with the budget crunch coming up, there is money to be saved by going private. Mr. Driscoll stated that earlier today, the committee let the State Fund out of the state Department of Administration because it is so cumbersome; maybe the state Department of Administration wants out of this because it is cumbersome. Mr. Wood said that from his experience, the captive group of state businesses can be taken away from the State Fund, but it will only last a year or two, and then they will be back with the State Fund. It is one of the larger premiums in the state, and everyone is going to bid for it. He believes it is a win-win situation for the state of Montana, because taxpayers will save money if someone bids lower, and if the State Fund gets it, it will help them stabilize. Rep. Laible said that up

until yesterday, he was in favor of peeling off a portion of the state agencies. He stated that to him, the most important concept is that the State Fund is the insurer of last resort. Until the creation of the State Fund, the rates were punitive to employers. The committee needs to remember the lessons of the past, and be sure that employers have readily available and affordable insurance. The State Fund will always have oversight by the legislature, so at this point, Rep. Laible does not want to take away part of their base. He believes that it might jeopardize what the committee is trying to do with the legislation, and based on the health of the State Fund, he believes that this is something legislators can look at in the future. Mr. Steinman asked for a show of hands. Four people were in favor of the State Fund continuing as the sole insurer, five people were against, and one abstained. Senator McNutt asked if there was any interest in setting a time frame, or if it should be done with the current bill. Senator Cocchiarella stated that she did not have a problem with setting some kind of a time frame, although she was not sure what that would mean, depending on effective dates. No state agency would be in a position to become self-insured for at least two years, maybe longer, because of the process they have to go through to get there. Senator Cocchiarella spoke regarding bundling of insurance - Missoula County is not with the rest of the counties for workers' compensation insurance - they are self-insured. They are putting together their own program for their health insurance, liability insurance and workers' compensation insurance, and they are saving Missoula County taxpayers thousands of dollars. She believes that if taxpayers realized that their government agencies could be freed up to save them thousands of dollars, either in the upcoming budget or somewhere in the future, and the committee is saying that it must take care of the State Fund, then it would be hard for the committee to defend. She believes that the state agencies deserve the opportunity to go out on their own and save the taxpayers money. Rep. Laible asked Mr. Swanson if there was a way to split off one agency, so that there is an opportunity for the free market system to work on an agency. Mr. Swanson stated that the legislature did that with the university system. Rep. Laible said that the university system was probably structured as a separate entity to begin with, whereas agencies are not. Senator Mahlum asked Mr. Bender if the Department of Administration is insured by the State Fund. Mr. Bender replied yes. Senator Mahlum asked if the Department of Administration was not required to be insured with the State Fund, who would make the decision of what company to go with. Mr. Bender stated that the first decision would be whether or not to even go with a company. The Department would decide whether to be self-insured or to go private. The Department would decide if it could save money by going either self-insured or with a private company, and is that worth the risk. If the Department were to go private there would be an RFP process. Senator Mahlum asked Mr. Bender what would happen if there was an agency under the Department of Administration that wanted to go private, but the Department did not want to. Would the Department release that agency? Mr. Bender responded that he would be reluctant to say that an executive branch agency can peel off. A branch of government is another question - i.e. the legislative branch or the judicial branch, which are not really under the Department of Administration's watch. The bottom line is it would take a tremendous amount of time, at least two years, for the Department to even think about going that way. Mr. Driscoll stated that when the university system was peeled off, the legislature gave them a certain number of years until they could do it. Mr. Driscoll suggested that maybe the stipulation could be that within a certain number of years, executive branch agencies would be free to self-insure or insure with private carriers. He was not sure what should be done with elected officials. Mr. Driscoll stated

that maybe having some alternative time frames would break the deadlock. Senator McNutt asked if Department of Administration decided to self-insure and then made an error, who would make up the error. He assumed that it would go back to the legislature. He stated that he is comfortable with Mr. Driscoll's suggestion of setting a date. Mr. Wood stated that he does not believe that the state agencies will become self-insured, because they are not a business, and self-insurance is for businesses. Mr. Wood reminded the committee that the legislature also released the counties, the cities and the school districts, who are all saving taxpayers money by being self-insured. In addition, contractors for public agencies used to be required to be insured by the State Fund. Rep. McKenney stated that philosophically, he agrees with the idea of state agencies being able to choose their insurance. However, he stated that he is looking out for the small businesses and the high-risk field, i.e. mechanics, timber workers, etc. Certainly, office workers and state agencies are low risk. If these low risks are taken from the State Fund, leaving them with the high risk, guaranteed market, he is afraid that costs will be driven up, and eventually it will cost jobs. That is why he believes that the state agencies should stay with the State Fund. Rep. Matthews spoke about MSF's priorities, and asked Mr. Swanson if there is a timeline when MSF would feel comfortable about letting the state agencies go. Mr. Swanson stated that it would be after July 1, 2005. That would give MSF July 03 and July 04. He stated that the key is, that right now, in the bill, MSF is paying premium tax, being exposed to punitive damages, and MSF will need to ensure that it is intact as a non-state agency, so that it will have flexibility. Mr. Steinman asked the committee if there could be a consensus on this particular issue. Rep. Laible asked if it would be possible to say that as of this new legislation, 25% of the state agencies will be open to bid, then in two years another 25%, etc. This would allow, within an eight-year period of time, all state agencies to go out on the open market and test the water. It would also give the State Fund an opportunity to grow its business and be more competitive. Rep. Matthews stated that he wants to do whatever it takes to make sure the State Fund can get to where it needs to be. He believes that Rep. Laible is trying to come up with a compromise, but that compromise would be a topic of discussion in the legislature. He believes that the committee would be better off setting a date and going from there. Senator McNutt stated that if the committee followed Rep. Laible's suggestion, it would put a tremendous burden on the Department of Administration to choose which agencies. He stated that he would be more comfortable with the July 1, 2005 opt out date, but he does have one concern. What happens, if on that date, Department of Administration does an RFP, and the State Fund has a better, less costly program? If that happens, there will be all kinds of dialogue about State Fund having an advantage or rate suppression because of too much surplus. The committee needs to realize that it may not be a utopia in letting the state agencies out. Senator McNutt agrees with Senator Cocchiarella and believes that if there is an opportunity, then the committee needs to investigate that. Rep. Matthews stated that he is concerned about the packages that private insurance companies come up with. Senator McNutt stated that in his opinion, the committee can't get into the business of micro-managing what private insurance companies can and can't do, but it is a fact that the State Fund can't do that. Rep. Laible stated that he has a concern about what happens in 2005 when the private insurers offer great package deals. In order for the State Fund to meet those rates, they will lose money, and the most important thing is to maintain the insurer of last resort. This plan could put the State Fund in jeopardy. Mr. Jones stated that it is a legitimate issue to be concerned about, but it is not a real issue. The state is only being

authorized to bid on workers' compensation, not on bundles, so it is not a problem. Senator McNutt asked if Liberty or any other large insurer insures property for the state. Mr. Jones replied that Liberty only writes workers' compensation in Montana. Mr. Mazurek stated that under state law, that is all under tort claims. Mr. Bender stated that the state does purchase private insurance, for vehicles, property, etc. Those are all private insurance lines. The state's self-insured fund is over actions of state government - tort damages, but the rest is from the private sector. Mr. Steinman asked if the committee had reached consensus. Rep. Matthews stated that perhaps in 2005-2006, if things continue to grow as they have since 1990, maybe the State Fund will have \$750 million in assets and \$450 million in liabilities, and it will not be an issue. He stated that we have to remember that the State Fund is doing a very good job, and what the committee is doing is protecting assets and surplus. Senator Cocchiarella stated that she was trying to come up with a compromise date, and she believes there needs to be something in the legislation that encourages the executive branch to investigate freeing up state agencies. Whether that is in this bill or not, she believes there should be consideration of that effort. Maybe this will force a look at what the issues really are. Ms. McClure stated that if they went into that statute, rather than doing a separate effective date, and said that it was effective July 1, 2005, she would think that agencies would be studying whether or not they wanted to be on their own. Mr. Steinman clarified that when MSF said July 1, 2005, they were really thinking of 2006 as the effective date. Ms. McClure stated that the effective date should be put into the statute, and would put the agencies on notice that on that date they are free to insure however they wish. Mr. Driscoll asked Ms. McClure about elected officials, and whether or not they would have to be mentioned. Ms. McClure replied that if the committee agreed that it wanted to include everyone, it would have to decide how to line that out. If the committee wanted to go with a phase out, it would be similar to what was done with schools. According to the statute, they had to go up 25% per year. She stated that Rep. McKenney remembers doing the pilot project, where they just selected agencies. Mr. Jones asked for clarification of the effective date. Rep. Laible stated that the effective date would be 2007, and the reasoning for that is that is the time period for when IT would be online. Mr. Steinman asked if the four people who wanted to keep the State Fund as sole insurer were willing to move into a compromise of phasing out in the future. Rep. Laible, Mr. Driscoll, and Rep. McKenney stated that they could live with that. Senator Mahlum stated that he would not budge. The committee's consensus was to free up the state agencies in 2007.

The next issue discussed was regulation of MSF by the Insurance Department. Mr. Jones asked Mr. Swanson or Ms. Butler if any of the current Board members had any experience in government regulation of a workers' compensation insurer before they came to the Board. Mr. Swanson asked if Mr. Jones meant oversight, and then stated that one of the Board members is Vice-President of Western States Insurance, but other than that, they are all business people. Mr. Jones clarified that he is not a regulator by experience. Mr. Swanson replied that that was correct and that was why he asked if he would substitute the word oversight, as in overseeing the business operations. Mr. Jones stated that he was trying to see if there is any experience on the Board of actually taking the government perspective of regulating an insurance company. Mr. Steinman asked if anyone had strong feelings for or against this issue. Senator McNutt stated that he was confused. There has to be legislative oversight, and they contract with actuaries to look at the safety and soundness of the State Fund, and they also look at

rates. He asked if this was a duplication of what is already being done, and if it is, why do it? Mr. Jones stated that he thinks the private auditor has less impartiality than the Insurance Commissioner has. Senator McNutt asked if it would be all right if they were told that they could not hire Tillinghast Towers Perrin, but must hire another company. Mr. Jones stated that there is no way to screen them that he is aware of. Also, there is the issue of timeliness. The auditor is called in periodically, whereas the Insurance Commissioner is always available to monitor the business affairs of an insurance company. The Insurance Commissioner has specific insurance expertise, not just with ratemaking, but also compliance with regulatory schemes, and they would have the staff onboard to do it because the staff would be paid for by the business being regulated. There is also a consumer protection issue. Currently, an injured worker who is employed by a policyholder of the State Fund is not able to go to the Insurance Commissioner with a complaint. Mr. Jones stated that this goes back to the level playing field. He asked what is so special about the State Fund that warrants this carve out to the regulatory requirement. In the alternative, if private carriers hire private auditors, can they be taken out of the regulatory authority of the Commissioner? Rep. Laible stated that he would like to see the State Fund under the regulation and oversight of the Insurance Commissioner. He stated that he is willing to discuss the requested exemptions, and that he would like to hear from Ms. Huschka. Ms. Huschka stated that the State Auditor's office has tried to get their hands around the exceptions. She believes it is true that because they are created by the legislature, the liquidation portion of regulatory oversight would be a recommendation to the governor and the legislature if there were a financial solvency issue. The Insurance Commissioner's office examines private carriers, but also does an annual desk audit every year and on a quarterly basis. Every domestic carrier is required to file their financial statement on a quarterly basis, and the Insurance Commissioner's office reviews that with a fine-toothed comb. They run all of the trend analyses, the ratios, and an in-depth financial analysis on a quarterly basis, tracking what is happening with the company every three months. On a yearly basis, they file a more in-depth report that has additional things that are not filed on a quarterly basis. That report is reviewed, and then once every five years an on-site exam is done to verify that the things that are being reported are really what is actually happening at the company. Then there is the rate review. Under the proposed legislation, when the Insurance Commissioner's office finds non-compliance, it can issue a report to the governor, the Board of Directors and the Legislative Auditor's Office. However, the Insurance Commissioner's office doesn't have the ability for enforcement the way they do with other carriers. If they find another carrier is on the verge of insolvency, the office can take supervisory action, which it can also do with the State Fund. If the office sees that the State Fund has violated some part of the statute, can they fine another state or public entity? This is similar to the punitive issue. Would the fine be paid out of surplus and capital, and thereby a deterrent, or would it actually be fining the general fund? The Insurance Department needs to be able to take administrative action, and compliance with items that they find on items that aren't being adhered to. If the legislature makes the decision that the State Fund will be regulated by the Insurance Department, then they will regulate that entity and determine if it can be done with the existing staff. The Department's concerns are the enforcement aspects. For example, there was a health carrier that was in financial trouble two years ago. The Insurance Department took them under supervision, put them into rehabilitation, and required them to raise their rates, which is a difficult thing to do in the health insurance world right now. The Department had to hire an outside actuary to

look at their reserves, rates and reinsurance program, and the Department had to make very difficult decisions about that company. They were successful in rehabilitating that company. Ms. Huschka stated that she does think the Insurance Department serves a purpose. Rep. Laible asked what oversight the Insurance Department has now over the State Fund. Ms. Huschka replied that there is none. Rep. Laible stated that this should be an improvement over what they currently have. Ms. Huschka agreed. Rep. Matthews asked Ms. Huschka how much this would cost. Ms. Huschka replied that the every five-year examination process would be between \$20,000 to \$50,000. The actuarial exam might be around \$10,000, although the Insurance Department's actuarial staff indicated that it would be higher than that because they would do a more in-depth rate review than the legislative auditors do. In terms of day-to-day costs, the State Fund is a very large carrier. The Insurance Department has some expertise in workers' compensation, but not a significant amount. Therefore, Ms. Huschka stated that she couldn't say that because of this one company they would increase staff in the examinations area, but she believes it could increase staff in the rate process, which would probably have to be contracted out for an actuarial review. The committee has already determined that fraud would be handled by the Department of Justice. If the Insurance Department were to be the fraud unit, she believes they would ask for the same amount of positions that Justice has, or at least the funding that is currently at Justice, and then would contract with the employees at Justice to do that. The Insurance Department would have to have appropriation authority in order to spend that money, even though it would be reimbursed by the State Fund. The Insurance Department also has an area of their office called Policyholder Services that fields complaints for private carriers. They field about 35,000 calls per year. Currently, private carriers' workers' compensation complaints go to the Employment Relations Division at the Department of Labor, and that is where complaints regarding the State Fund go also. Rep. Matthews stated that this is one issue where he wanted to hear how the State Auditor felt, and he feels that if its not broke, don't fix it. Rep. McKenney stated that he is undecided, although he is leaning in the direction that he thinks it is appropriate for the Insurance Commission to regulate and oversee the State Fund, knowing that the legislature never gets away from its duty of making sure the State Fund is on sound footing. Mr. Wood asked Ms. Huschka if the supervision by the Insurance Commissioner could be adjusted for using what the legislative auditor does to avoid duplication, or if it would be better to cut it clean. Ms. Huschka stated that she does not know exactly what the legislative auditor does. It is her understanding that they review the financial reports of the State Fund on an annual basis and issue a report. She does not know what they look at; what kind of ratios they use, trend analysis, or what kind of comparisons they make to other companies. Do they go on site and verify those amounts with what is at the company? Do they do any kind of in-depth testing of premium and making sure that the premium is calculated the same way every time? She is not sure that they do those types of things. As far as the actuarial review, she assumes they look at what Tillinghast provides to them for reserves, but she is not sure they go in-depth and look at how rates are calculated and how they are calculated across each classification. Ms. Huschka stated that it would be hard for her to say whether or not they could work jointly to save some costs, or if it is truly duplicative to have them do their review. She stated that she was once told that what the legislative auditor looks at is the same kind of things the legislative auditor looks at when they review the Insurance Department's books, which they do every two years. If that is the case, then there is no real insurance review.

Mr. Driscoll stated that a person from the Legislative Audit Division was at the meeting, and asked her to clarify this issue. Jean Carstensen-Garret, of the Legislative Audit Division, stated that they do a financial audit of the State Fund each year, and does not think there is duplication between the regulation function of the State Auditor's office and what Legislative Audit does, except for the rate review they contract out for with an independent actuary. She thinks there would be some duplication there. Mr. Driscoll asked if that was a constitutional duty of the legislative fiscal auditor to audit all agencies. Ms. Carstensen-Garret replied that it is, but the constitution does not provide for a rate review. Mr. Driscoll stated that if the committee took out the rate review by the Legislative Audit Division, and gave it to the Insurance Commissioner, there would be no duplication. Rep. Laible stated that it seems to him that in the bill, the State Fund will fall under the supervision of the Insurance Commissioner's office. There is no oversight now, and some oversight has been provided with the legislation, with some exemptions. Rep. Laible said that the question is, does the committee want the bill as it is, then take a look at the exemptions and decide which ones the committee can live with or can't live with? He understands that it will add some labor to the Insurance Commissioner's office, but if there was no State Fund and there were only private carriers, that burden would go there anyway. Because the State Fund is a public entity, maybe there needs to be double oversight. Mr. Mahlum asked Mr. Swanson for his thoughts on this issue. Mr. Swanson replied that he believes Insurance Department regulation would be a good thing, with the exemptions. The exemptions have to be in there, but it would be a positive move. If the exemptions cannot remain in the bill, then MSF's support for moving in that direction would be removed. Currently, the Legislative Audit Division is required to do the financial compliance audit. They come onto the premises for weeks at a time, then work offsite, and put together the Blue Book - the financial audit that goes to the state. All other aspects of the rate review and reserves being adequate would move over to the Insurance Commissioner's office. With the exemptions that are in the bill, MSF would be supportive of going in that direction. One exemption is that the Board of Directors currently has the ability to approve MSF's rates, and MSF would want that to continue, because it is the guaranteed market, and can't say no. If there was a situation someday, where someone wouldn't allow rate adequacy, MSF would be forced to under price business, as occurred during the Old Fund days. Therefore, the Board needs to maintain that fiduciary responsibility and have control over MSF's destiny. However, the Insurance Department has some authority because they would issue a report annually to the Governor's Office, the legislature, the Legislative Audit Division and the Board of Directors. Senator Mahlum asked if Mr. Swanson feels that the Legislative Audit Division gives MSF as good an audit as the Insurance Commissioner would. Mr. Swanson stated that if MSF were under the Insurance Department, it would have further oversight that it does not have currently. The Legislative Audit Division hires an outside, independent actuary who looks over MSF's actuary, and issues a report on whether rates and reserves are adequate, excessive or unfairly discriminatory. There are other aspects of Insurance Department oversight, which MSF would need to prepare for, such as market conduct reviews. The other exemptions are that MSF needs the ability for the Board to approve exceptions on some of the NCCI classifications, the Certificate of Authority needs to be continuous and can't be revoked, no liquidation or dissolution, doing all reporting on a fiscal versus calendar year basis until the switch can be made, exemptions from Chapter 3 on organization of a mutual because of MSF's enabling statutes, and one clause requiring the Board of

Directors to get involved in investments. Mr. Swanson stated that there would be a lot of work to do to get ready for this, but he believes it is ultimately a good direction. Rep. McKenney excused himself from the meeting, but stated that he supports the move to put regulation into the Insurance Commissioner's office, with the exemptions. Senator Cocchiarella stated that she does not like the concept of double oversight, and that she would support this concept, with the exemptions, as long as there is no duplication in the reviews. She does not want the legislature to drop its responsibility in oversight. Ms. Butler replied that they each might have a slightly different approach, but there is going to be some natural overlap. The Insurance Commissioner will do an examination for financial integrity like an insurance company, and meanwhile Legislative Audit Division will do a financial audit. They might each have a slightly different focus, but it will be duplicate work for some of it because they will be looking at the same numbers. Senator Cocchiarella stated that she has a problem with increased costs. Mr. Steinman asked for a show of hands. Seven people were in favor of regulation by the Insurance Department with exceptions. Senator McNutt asked if there is any way this could be structured so that duplication could be minimized. The State Auditor shouldn't have to hire an actuary to look at what the Commissioner is going to look at. Mr. Wood stated that if the part about reviewing rates was struck, that is what the committee would have. Mr. Driscoll stated that if the first sentence of §39-71-2362 were taken out, then the rate review would only be done by one person, instead of by two. Ms. Butler stated that would be moved to the Insurance Commissioner, but Legislative Audit Division was very strong on continuing to do a financial audit. Ms. Butler stated that the Insurance Commissioner would also be very strong on doing a financial audit. Senator McNutt asked if a rate review could be done without a financial review. Mr. Swanson stated that he believes they are completely different. The Legislative Audit Division spends weeks reviewing the record keeping regarding premium and expenses so it is accurate. In the Insurance Department's financial audit, they run analyses and ratio tests, because every private carrier provides them a financial statement. Ms. Huschka stated that the Insurance Department does do premium tests and that sort of thing on site every five years. Mr. Swanson stated that perhaps that piece would not need to be duplicated because the Legislative Audit Division is already doing that. Ms. Huschka stated that both entities would have to take a look at what the other one is doing. Mr. Driscoll stated that the bill says the Auditor shall review rates. He asked why the Auditor and the Insurance Commissioner both have to do that. Mr. Swanson replied that Mr. Driscoll was looking at the bill that took everything out but Priority #1, and does not include regulation by the Insurance Department. Looking at reserves, reserve adequacy, rates, etc. would become a function of the Insurance Department, and the Legislative Auditor would become responsible for the financial compliance audit.

Mr. Kibbee asked Mr. Swanson if the rates come under the Insurance Department, would they have the ability, if the Board set rate was below the loss cost variable, to say that it must be prior approved? Mr. Swanson replied that what the Insurance Department could do, is write a report to the Legislative Audit Division, the Governor and the Board of Directors, indicating that they believe the rates are inadequate, excessive or unfairly discriminatory. As Ms. Huschka indicated, the Insurance Department would have the ability to fine MSF, put MSF under supervision or take it into rehabilitation like any private carrier, or take MSF to a court of appropriate jurisdiction and have them found insolvent. However, the Insurance Department could not dissolve MSF. Ms. Huschka stated that what the Insurance Department currently does with

private carriers on rates is if it is below the loss costs, it is prior approval. Mr. Swanson stated that the Insurance Department would not have that authority with the State Fund. They would have the authority to raise a red flag, so the legislature could decide what to do. The Board of Directors would maintain its current authority for ensuring that rates are adequate, and that there is no political interference with that process. Mr. Swanson stated that his concern is that this has occurred as recently as the late 1980's and early 1990's in many states. MSF can't say no, or decide to leave the state like a private carrier. Mr. Jones asked if Commissioner Morrison has indicated whether he would support this proposal; where he would have oversight but no regulatory authority. Ms. Huschka stated that if the Insurance Department were to regulate MSF, they would like it to be the same as every other carrier to make it a complete level playing field. This will not happen because of the guaranty issue, with regards to solvency. This is where the Insurance Department has said they have regulatory oversight, but no authority regarding rates. If it is determined by the legislature that the Insurance Department will regulate the State Fund, then they will, but it would be their preference to regulate them as closely as they do every other private carrier, with the exception of being able to liquidate or dissolve that entity. Mr. Swanson stated that if the legislation cannot be approved with the exemptions, he would ask the committee to not support moving towards Insurance Department regulation, and leave it the way it is. Mr. Steinman stated that the committee's consensus was to approve regulation and oversight by the Insurance Commissioner with exceptions. Essentially, since the committee has already reached consensus, the only real question is whether the committee wished to approve Mr. Driscoll's suggestion of striking the sentence in § 39-71-2362 or to try to minimize as much duplication as possible. Mr. Wood stated that the committee has not resolved one issue. Will the Insurance Commissioner accept the duties with the exceptions, or will they fight the bill in the legislature? Ms. Huschka stated that she couldn't say whether the final decision will be to fight the bill if it's put forth. Rep. Laible stated that the only exception that seems to be a problem is the oversight of the rates. Mr. Swanson replied that that is the most important one to him. He stated that it is very important that the Board of Directors maintains this ability, and if that can't be done, he would like to pull it off the table. Ms. Huschka stated that she is not sure that it is just her office that would oppose this, but that there would probably be other opposition. Senator McNutt stated that nothing in the bill is sacred, but the committee needs to start with a bill draft. He personally does not believe the Insurance Commissioner piece should be in the bill, because it is not broken, but he will not object if the committee wants it in the bill. He believes it will be a huge problem. Mr. Wood suggested that the State Fund put a bill together, based on the committee's conversation, then send it to each committee member to comment and ask questions. Then if it is necessary, the committee can return and have a meeting at the call of the chair. That way, the committee would get to the point where they are all talking about the same thing. Senator McNutt stated that he believes that is a good suggestion, and the committee also needs to bear in mind that they need to do a report to the legislature of the committee's findings. Rep. Laible commented that if the bill fails, the State Fund will be back to the way it is now, still doing 85% of the business, and not paying any premium tax. He believes this bill brings it closer to a level playing field. Senator Cocchiarella asked if everyone got Kleinkopf's letter regarding Life Care Services, and the issue of the State Fund being able to buy up for-profit entities like Blue Cross/Blue Shield did. Mr. Swanson stated that MSF is taking care of that issue. Mr. Swanson asked Senator McNutt if he could get an idea of how the committee feels about the Insurance

Commissioner Regulation issue. Senator Cocchiarella stated that it was adopted with the exceptions.

The meeting was adjourned